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No. 92-1511

In the Supreme Court of the United States

OCTOBER TERM, 1993

JACK J. GRYNBERG AND CELESTE C. GRYNBERG,
PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Internal Revenue Service is precluded by confirmation of petitioners' joint bankruptcy reorganization plan from collecting a nondischargeable prepetition gift tax liability, where the liability was not asserted nor its merits adjudicated in the bankruptcy proceeding.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	6
Conclusion	10
Appendix	1a

TABLE OF AUTHORITIES

Cases:

Begier v. *IRS*, 496 U.S. 53 (1990)	7
Gwilliam v. *United States*, 519 F.2d 407 (9th Cir. 1975)	9
Hoffman v. *Connecticut Dep't of Income Maintenance*, 492 U.S. 96 (1989)	5
Lesser v. *Gray*, 236 U.S. 70 (1915)	10
United States v. *American Surety Co.*, 56 F.2d 734 (2d Cir. 1932)	10
United States v. *Gurwitch*, 794 F.2d 584 (11th Cir. 1986)	5, 8, 10
United States v. *Nordic Village, Inc.*, 112 S. Ct. 1011 (1992)	9

Statutes:

Bankruptcy Code, 11 U.S.C. 101 *et seq.*:	
11 U.S.C. 106(c)	9
11 U.S.C. 501(c)	2, 5, 8
11 U.S.C. 505	4, 8
11 U.S.C. 507	1a
11 U.S.C. 507(a)(7)(E)	4, 6
11 U.S.C. 523	3, 4, 5, 6, 8
11 U.S.C. 523(a)(1)(A)	4, 6, 1a-2a
11 U.S.C. 532(a)(1)(B)(i)	3, 6, 2a
11 U.S.C. 1141	8, 2a
11 U.S.C. 1141(d)	7
11 U.S.C. 1141(d)(1)	6

Statutes—Continued: Page

11 U.S.C. 1141(d)(2) 4, 6, 3a

Miscellaneous:

124 Cong. Rec. (1978):
p. 32,350 7
p. 32,408 7
p. 34,008 7

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A32-A42) is reported at 986 F.2d 367. The order of the district court (Pet. App. A19-A31) is reported at 142 Bankr. 415. The order of the bankruptcy court (Pet. App. A1-A18) is unofficially reported at 91-2 U.S. Tax Cases (CCH) ¶ 60,076.

JURISDICTION

The judgment of the court of appeals was entered on February 17, 1993. The petition for a writ of certiorari was filed on May 18, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

In February 1981 petitioners filed separate petitions for relief under Chapter 11 of the Bankruptcy Code (11 U.S.C.). Their cases were jointly administered. Pet. App. A33. The United States was listed on petitioners' bankruptcy schedules as holding disputed claims for income taxes and gift taxes. The disputed gift tax liability arose from numerous intra-family transfers of mineral properties made during the year preceding their bankruptcy filings. Petitioners never filed gift tax returns concerning those transfers, because they maintained that such transfers were not taxable gifts. *Id.* at A33-A34.

In connection with the joint proceeding, the bankruptcy court issued the following "bar order":

> Creditors holding claims scheduled by Debtor as disputed, contingent, or unliquidated shall file a proof of claim with this Court on or before July 31, 1981 [the "bar date"] . . . Failure to file a proof of claim shall forever bar a creditor holding a disputed, contingent, or unliquidated claim from participation in this proceeding or in any distribution under a plan filed by the Debtor.

Pet. App. A34, quoting C.A. App. 36. The Internal Revenue Service filed a timely proof of claim for federal income taxes for the years 1974-1979, but filed no claim with respect to the scheduled gift taxes. Pet. App. A34. Petitioners did not file a claim on behalf of the Internal Revenue Service under 11 U.S.C. 501(c). Pet. App. A42.

In March 1989, after petitioners' plan of reorganization had been fully consummated,[1] the IRS sent a letter to petitioner Jack Grynberg notifying him of a proposed gift tax deficiency (and associated penalties) totalling approximately $5 million, based on the mineral property transfers made in 1980 and 1981.[2] Pet. App. A21, A34. In response, petitioners filed an adversary complaint in the bankruptcy court, seeking to enjoin the IRS from taking any action to collect the asserted gift tax liability on the ground that the gift tax was disallowed under the bar order and discharged in the bankruptcy case upon completion of the reorganization plan. *Id.* at A34-A35.

The bankruptcy court granted the government's motion for summary judgment and dismissed the adversary complaint. The court held, Pet. App. A6-A8, that confirmation of petitioners' reorganization plan did not release them from the asserted gift tax liability because the taxes at issue, if in fact due, were excepted from discharge under 11 U.S.C. 523, both as taxes "with respect to which a return, if required * * * was not filed" (11 U.S.C. 523(a)(1)(B)(i)) and as excise taxes with respect to which returns were due within three years before the filing of the petition

[1] In April 1982 the bankruptcy court confirmed a joint reorganization plan in the petitioners' Chapter 11 cases. The claim for income taxes was the only federal tax liability dealt with in the reorganization plan. Neither the plan nor the accompanying disclosure statement made reference to any gift tax liability. Pet. App. A2-A3.

[2] On March 22, 1991, the Commissioner of Internal Revenue issued a final notice of deficiency, which petitioner is challenging in the Tax Court. See *Grynberg* v. *Commissioner*, No. 12918-91 (U.S. Tax Ct.). The Tax Court proceeding is currently stayed pending final disposition of this case.

(11 U.S.C. 507(a)(7)(E), 523(a)(1)(A)). The court rejected, Pet. App. A8-A13, petitioners' arguments that the government's failure to assert the gift tax claim in the bankruptcy proceeding equitably estopped it from collecting the tax after bankruptcy, and that the bar order and the confirmation order precluded post-bankruptcy collection under principles of res judicata. Finally, while recognizing that it had jurisdiction under 11 U.S.C. 505 to adjudicate the merits of the dispute over whether the asserted tax and penalties were in fact due, the bankruptcy court abstained in deference to the greater administrative and judicial expertise of available alternative forums. Pet. App. A15-A16.

The district court affirmed. Pet. App. A19-A31. It agreed with the bankruptcy court that confirmation of the reorganization plan did not affect petitioners' nondischargeable liability for any gift tax that was due, and that the bar order entered in the bankruptcy case did not bar the IRS from seeking to collect the gift tax liability outside of bankruptcy. *Id.* at A24-A26.

The court of appeals, in turn, affirmed the judgment of the district court. Pet. App. A32-A42. Like the two lower courts, it held that 11 U.S.C. 523, when read in conjunction with 11 U.S.C. 1141(d)(2), excepted the gift tax liability from the general discharge that occurred upon confirmation of the reorganization plan. Pet. App. A35-A36. The court observed that an adverse determination of the tax claim on the merits would have barred the IRS from pursuing the claim after bankruptcy; disallowance for untimeliness, on the other hand, precluded the government from participating in distributions from the bankruptcy

estate under petitioners' reorganization plan, but did not prevent it from seeking to collect outside the plan. *Id.* at A37-A40. The court observed that although this result might "conflic[t] with the 'fresh start' policy animating the [Bankruptcy] Code's discharge provisions, 'it is apparent to us that Congress has made the choice between collection of revenue and rehabilitation of the debtor by making it extremely difficult for a debtor to avoid payment of taxes under the Bankruptcy Code.'" *Id.* at A40, quoting *United States* v. *Gurwitch*, 794 F.2d 584, 585-586 (11th Cir. 1986).

The court also rejected petitioners' suggestion that under this Court's decision in *Hoffman* v. *Connecticut Dep't of Income Maintenance*, 492 U.S. 96 (1989), the failure of a governmental unit to submit a proof of claim renders the claim dischargeable even if otherwise non-dischargeable under Section 523. Noting that *Hoffman* addressed a jurisdictional question, the court explained that "the fact that a governmental unit is subject to bankruptcy court jurisdiction on the question of dischargeability even if it never filed a proof of claim does not mean that a governmental unit's failure to file a proof of claim on a nondischargeable debt necessarily results in discharge." Pet. App. A40 n.7. Finally, the court observed, *id.* at A41-A42, that "[petitioners'] difficulties might easily have been averted" by recourse to 11 U.S.C. 501(c), which allows a debtor to file proof of a creditor's nondischargeable claim, thereby forcing evaluation of the claim, inclusion of any allowable amount among the claims to be paid from the bankruptcy estate, and thus elimination or reduction of the non-dischargeable amount that will remain to be paid from other assets after the closing of the bankruptcy case.

ARGUMENT

The court of appeals correctly affirmed the decision of two lower courts that petitioners' gift tax liability was not discharged in their bankruptcy proceeding, and that neither the bar order entered in the case nor the order confirming their bankruptcy reorganization plan precluded the IRS from collecting the tax outside bankruptcy. That decision does not conflict with any decision of this Court or of another court of appeals, and no further review is warranted.

1. Section 1141(d)(1) of the Bankruptcy Code (11 U.S.C.) provides generally that upon confirmation of a Chapter 11 plan of reorganization, the debtor is discharged of pre-existing debts, whether or not a proof of claim was filed or the claim was allowed. See App., *infra*, 2a-3a. Section 1141(d)(2) provides, however, that confirmation does not discharge an individual debtor from any debt excepted from discharge under 11 U.S.C. 523. Section 523 excepts from discharge debts for, among other things, excise taxes arising from transactions occurring (or with respect to which a return must be filed) within three years of bankruptcy, and taxes with respect to which a required return was not filed. 11 U.S.C. 523(a)(1)(A), 523(a)(1)(B)(i), 507(a)(7)(E); see App., *infra*, 1a-2a.

Despite the clear language of Sections 1141(d)(2) and 523, petitioners assert that the IRS's failure to file a proof of claim asserting the gift taxes as a claim against the bankruptcy estate should preclude the IRS from pursuing collection of the tax liability after bankruptcy. Petitioners maintain, Pet. 15-16, that unless the government is barred from seeking to collect unfiled tax claims after the reorganization plan is confirmed, successful reorganization will be

impossible. All three courts below correctly rejected this request to rewrite the bankruptcy statute.

Congress was well aware of the uncertainty that exceptions from discharge create, but decided to permit such uncertainty in cases filed by individual debtors in order to protect certain categories of claims. Indeed, for precisely the reasons petitioners suggest, Congress rejected a version of Section 1141(d) that would have excepted taxes from discharge in all Chapter 11 cases, and instead limited the discharge exception to cases involving individuals rather than corporations and partnerships:

> It is necessary for a corporation or partnership undergoing reorganization to be able to present its creditors with a fixed list of liabilities upon which creditors or third parties can make intelligent decisions. Retaining an exception for discharge with respect to nondischargeable taxes would leave an undesirable uncertainty surrounding reorganization that is unacceptable.

124 Cong. Rec. 32,350, 32,408 (1978) (statement of Rep. Edwards); *id.* at 34,008 (statement of Sen. DeConcini).[3] As the court of appeals correctly observed (Pet. App. A40), in the case of individual debtors Congress consciously opted to place a higher priority on revenue collection than on debtor rehabilitation or the provision of a "fresh start." Accord

[3] This Court has viewed the floor statements of Representative Edwards and Senator DeConcini, reporting the results of closed-door conferences that were held in lieu of a formal conference to reconcile the House and Senate bankruptcy bills, as persuasive evidence of congressional intent. *Begier* v. *IRS*, 496 U.S. 53, 64 n.5 (1990).

United States v. *Gurwitch*, 794 F.2d 584, 585-586 (11th Cir. 1986).

Although petitioners are not entitled to the benefit of a discharge of the gift tax, they were at all times free, as the court of appeals pointed out (Pet. App. A41-A42), to file a claim on behalf of the IRS so that the gift tax liability could be taken into account under the reorganization plan. 11 U.S.C. 501(c). Petitioners listed the asserted gift taxes as disputed obligations on their schedule of liabilities, and thus were well aware of their potential liability. They were also on notice of the nondischargeability of such obligations under Sections 1141 and 523. Under the circumstances, petitioners' complaint (Pet. 16) that the decision in this case has enabled the IRS to "ambush" them after reorganization is unpersuasive.

The courts below also properly rejected petitioners' arguments about the effect of the bar order.[4] That order purported to do nothing more than bar creditors who filed after the bar date "from participation in this proceeding or in any distribution under a plan filed by the Debtor." Pet. App. A34. It did not adjudicate the merits of unfiled or late-filed claims, as petitioners appear to argue (Pet. 12-14). Thus, it had no res judicata consequences as to the merits of the gift tax liability. As the court of appeals correctly noted, Pet. App. A41-A42, petitioners could have invoked the jurisdiction of the bankruptcy court under 11 U.S.C. 505 to determine the merits of the gift tax. Such an adjudication on the merits would have been determinative even after the bankruptcy. Having elected not

[4] It is particularly noteworthy that the bankruptcy court agreed with the government about the scope and effect of its own order. Pet. App. A8-A9.

to pursue that course, petitioners are still free to contest their substantive liability in the Tax Court.

2. The decision of the court of appeals does not conflict with any decision of this Court or of another court of appeals. Contrary to petitioners' contention, Pet. 7-10, the court of appeals did not hold that bankruptcy courts are without jurisdiction to determine the tax liabilities of debtors unless the taxing authority files a proof of claim. Rather, the court held that petitioners did not invoke the jurisdiction of the bankruptcy court to adjudicate the merits of the gift tax liability in their bankruptcy case. Thus, the court's ruling does not conflict with *Gwilliam* v. *United States*, 519 F.2d 407 (9th Cir. 1975), which has been codified in Sections 106(c) and 505 of the current Bankruptcy Code. See *United States* v. *Nordic Village, Inc.*, 112 S. Ct. 1011, 1016 (1992).

Nor does the court's decision conflict with the various cases cited by petitioners, Pet. 10-11, for the general (and unobjectionable) proposition that creditors are bound by bankruptcy claims adjudication and discharge orders as well as by orders confirming plans of reorganization. The res judicata effect of such orders was not at issue in this case. The bankruptcy court did not adjudicate the merits of the tax claim, the reorganization plan did not purport to deal with it, and the discharge had no effect on a claim that the statute specifically provides is nondischargeable.

Finally, contrary to petitioners' contention (Pet. 14), the court's decision creates no tension with cases holding that a claim will be disallowed if it is not asserted through a timely filed proof of claim. Indeed,

the court of appeals stated, Pet. App. A39, that the government's failure to file a proof of claim did preclude it from voting on or receiving distributions under petitioners' plan. The cases cited by petitioners do not hold, as petitioners imply, that a claim will be disallowed on the merits because it is filed late. Petitioners offer no decision to support that proposition, and there is no conflict on the point. *Gurwitch*, 794 F.2d at 585; see also *Lesser* v. *Gray*, 236 U.S. 70 (1915); *United States* v. *American Surety Co.*, 56 F.2d 734, 736 (2d Cir. 1932) (disallowance of claim on grounds not going to the merits does not bar claimant from recovery from debtor personally in subsequent proceeding).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

11 U.S.C. 507. Priorities

(a) The following expenses and claims have priority in the following order:

* * * * *

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—

* * * * *

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

* * * * *

11 U.S.C. 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required—

(i) was not filed; or

(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

* * * * *

11 U.S.C. 1141. Effect of confirmation

* * * * *

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—

(A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title, whether or not—

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

* * * * *